



Multistate Tax Commission Memorandum

States Working Together Since 1967 . . . To Preserve Federalism and Tax Fairness

To: Compact Member State Representatives of the Multistate Tax Commission
From: Dan R. Bucks, Executive Director
Date: April 9, 2003
Subject: Bylaw 7 Survey of Member States regarding Uniformity Proposal on Reporting Options For Non-resident Members of Pass-through Entities

This memorandum includes an official survey required by the Commission's Bylaws as an essential part of developing a uniformity recommendation. Your response to this survey is requested by Tuesday, May 9, 2003. We thank you in advance for your cooperation.

Enclosed please find a Bylaw 7 Survey Response Form for the Proposal on Reporting Options for Nonresident Members of Pass-through Entities ("Pass-through Entity Proposal"). The Pass-through Entity Proposal was developed to bring uniformity to the reporting options for nonresident members. A Public Hearing on the proposal was conducted in Washington DC on December 17, 2002.

If your State is an "affected State" within the meaning of Bylaw 7 (see list below), we request that you return a completed survey response form by mail, fax or e-mail on or before May 9, 2003. As indicated on the survey form, all responses should be directed to Loretta King by fax at 202-624-8819, e-mail at lking@mtc.gov or mail at the MTC office in DC.

At its meeting held January 16, 2003, the Executive Committee of the Commission authorized the conduct of a Bylaw 7 survey with respect to the adoption of the Pass-through Entity Proposal. The proposal presents uniform language providing for an optional composite return for pass-through entities to report and pay tax on the pro rata distributive share of income of nonresident members. It also requires withholding of tax on income actually distributed to nonresident members unless (1) they have elected to be part of a composite return, (2) their distributed income fall below a \$1000 threshold or (3) the tax agency exempts the member from withholding by rule or regulation. Pursuant to the requirements of Bylaw 7 of the Commission, the Executive Committee has referred the proposal to all Compact Member States of the Commission "to determine if the affected members will consider adoption of the recommendation within their respective jurisdictions." If a majority of the "affected members" indicate that they will consider adoption of the proposal, the Pass-through Entity Proposal will be presented for final action as a Commission uniformity recommendation to the states at the Commission's regularly scheduled meeting to be held August 1, 2003, in Salt Lake City, Utah. If your State is an "affected member," your vote on the attached survey is an important step to bringing the proposal to the vote of the Commission.

Please do not hesitate to contact me through 202-624-8699 or by e-mail at dbucks@mtc.gov if you have any questions about the proposal or the procedure that is being followed in this instance.

List of Affected and Unaffected Multistate Tax Compact Member States

<u>Affected Member States</u>	<u>Unaffected Member States</u>
Alabama	South Dakota
Alaska	Texas
Arkansas	Washington
California (Franchise Tax Board)	
Colorado	
District of Columbia	
Hawaii	
Idaho	
Kansas	
Maine	
Michigan	
Minnesota	
Missouri	
Montana	
New Mexico	
North Dakota	
Oregon	
Utah	

Through the resolution authorizing this survey, the Executive Committee has determined that an affected State within the meaning of Bylaw 7 is any full Member State that has a personal income tax. This list reflects our best understanding of which Member States are appropriately classified as an "affected State" within the meaning of Bylaw 7 and which are not. **If you believe we have erroneously classified your State in the *List of Member States*, please advise us of that fact and the basis upon which you have reached the contrary conclusion. If you are an "affected State," regardless of how your State is classified on the *List of Member States*, please be sure to return your survey in all events.**

MULTISTATE TAX COMMISSION—BYLAW 7 SURVEY RESPONSE FORM

**Proposal on Reporting Options for
Nonresident Members of Pass-through Entities**

*Please return by **May 9, 2003**, by mail, fax or e-mail to:*

Ms. Loretta King

Multistate Tax Commission

444 N. Capitol Street, N.W., Suite 425, Washington, D.C. 20001

FAX: (202) 624-8819—Phone: (202) 624-8699—e-mail: king@mtc.gov

From:

Name of Tax Agency Official

Jurisdiction: _____

The MTC Hearing Officer for the Public Hearing on the proposed adoption of the Proposal on Reporting Options for Nonresident Members of Pass-through Entities has recommended adoption of the Proposal and the conduct of a Bylaw 7 survey to determine the Member States' interest in considering adoption of the proposal. The recommended proposal is attached to this Survey Response Form as *Exhibit A*. Should you wish a copy of the Hearing Officers' final report, please contact Ms. Loretta King at the Commission's headquarters office at 202-624-8699.

The purpose of this survey is to determine how many affected Multistate Tax Compact Member States would consider adopting the proposal if it were adopted as a uniformity recommendation by the Commission.

The question for your consideration and response is as follows:

If the Commission were to recommend to its affected Member States the adoption of the Proposal on Reporting Options for Nonresident Members of Pass-through Entities (which is attached hereto as Exhibit A), would your agency consider adoption of the proposal?

[] YES

[] NO

If you have marked "NO" as your answer above, but a change in the proposal would change your answer to "YES", please note such changes or other comments that you might have on the next page.

Comments and/or suggested changes (attach additional sheets if necessary):

EXHIBIT A

Proposal on Reporting Options for Non-resident Members of Pass-through Entities

Section 1. Definitions.

A. “Pass-through entity” means a corporation that for the applicable tax year is treated as an S Corporation under [IRC §1362(a), or State Tax Code §], and a general partnership, limited partnership, limited liability partnership, trust, or limited liability company that for the applicable tax year is not taxed as a corporation [for federal tax purposes] [under the state’s check-the-box regulation];

B. “Member” means [*optional additional language*: an individual who is] a shareholder of an S corporation; a partner in a general partnership, a limited partnership, or a limited liability partnership; a member of a limited liability company; or a beneficiary of a trust;

C. “Nonresident” means an individual who is not a resident of or domiciled in the state, a business entity that does not have its commercial domicile in the state, and a trust not organized in the state.

Section 2. Composite Return Authorized.

A. A pass-through entity may file a composite income tax return on behalf of electing nonresident members reporting and paying income tax at the highest marginal rate provided in [state tax rate provision] on the members’ pro rata or distributive shares of income of the pass-through entity from doing business in, or deriving income from sources within, this State.

B. A nonresident member whose only source of income within a state is from one or more pass-through entities may elect to be included in a composite return filed pursuant to this section.

C. A nonresident member that has been included in a composite return may file an individual income tax return and shall receive credit for tax paid on the member’s behalf by the pass-through entity.

Section 3. Withholding Required.

A. A pass-through entity shall withhold income tax at the highest tax rate provided in [section x for individuals or section y for corporations or section z for other entities] on the share of income of the entity distributed to each nonresident member and pay the withheld amount in the manner prescribed by the [tax agency]. The pass-through entity shall be liable to the [state] for the payment of

the tax required to be withheld under this section and shall not be liable to such member for the amount withheld and paid over in compliance with this section. A member of a pass-through entity that is itself a pass-through entity (a “lower-tier pass-through entity”) shall be subject to this same requirement to withhold and pay over income tax on the share of income distributed by the lower-tier pass-through entity to each of its nonresident members. The [tax agency] shall apply tax withheld and paid over by a pass-through entity on distributions to a lower-tier pass-through entity to the withholding required of that lower-tier pass-through entity.

B. A pass-through entity shall, at the time of payment made pursuant to this section, deliver to the department a return upon a form prescribed by the department showing the total amounts paid or credited to its nonresident members, the amount withheld in accordance with this section, and any other information the department may require. A pass-through entity shall furnish to its nonresident member annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax withheld on behalf of such member on a form prescribed by the department.

C. Notwithstanding subsection A, a pass-through entity is not required to withhold tax for a nonresident member if

- (1) the member has a pro rata or distributive share of income of the pass-through entity from doing business in, or deriving income from sources within, this State of less than \$1,000;
- (2) the [tax agency] has determined by regulation, ruling or instruction that the member’s income is not subject to withholding; or
- (3) the member elects to have the tax due paid as part of the pass-through entity’s composite return under Section 2.